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SUPREME COURT U.S.

No. 170

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION, PETITIONER

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER, GENERAL STORES CORPORATION

AARON ROSEN,
Counsel for Petitioner,
Otterbourg, Steindler, Houston & Rosen,
200 Fifth Avenue,
New York 10, N. Y.

FREDERIC P. HOUSTON,
MARKS F. PASKES,
MELVIN LIEBOWITZ,
Of Counsel.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S BRIEF

General Stores Corporation seeks reversal by this Court of the Judgment of the Court of Appeals for the Second Circuit, which affirmed by a divided court (2 to 1, with three separate opinions), the judgment of the United States District Court for the Southern District of New York in Proceedings for an Arrangement under Chapter XI of the Bankruptcy Act. Although the debtor seeks under that Chapter to compose its general unsecured trade and commercial debts, none of which is evidenced by any publicly held security, a single stockholder of the debtor and the Securities and Exchange Commission have nevertheless thwarted the proceeding by obtaining a judgment

dismissing the Arrangement proceedings under Chapter XI unless the petition is amended to comply with the provisions for Reorganization under Chapter X of the Bankruptcy Act.

Opinions Below

The opinions of the Court of Appeals are reported at 222 F. 2d 234. The opinion of the District Court is reported at 129 F. Supp. 801.

Jurisdiction

Petition for Certiorari was filed June 22, 1955. Certiorari to the Court of Appeals of the Second Circuit was granted by this Court on October 10, 1955, by authority of 28 U. S. C. 1254(1). See also Section 24(c) of the Bankruptcy Act, 11 U. S. C. 47(c).

Constitutional Provisions and Statutes Involved

All of the pertinent provisions of the United States Constitution, *i.e.*, Article I, Section 1 and Section 8, Clause 4; and of the Bankruptcy Act of 1898, Section 12; the Bankruptcy Act of 1938 (the Chandler Act) and the amendments of 1952, are set forth in the Appendix, *infra*, pages 43-51, *et seq.*

Questions Presented

1. Whether a corporate debtor can be denied the right to proceed under Chapter XI where it seeks merely an arrangement or composition of its general unsecured trade

and commercial debts not evidenced by any publicly held securities and where in no sense does it seek a corporate reorganization or any change whatsoever in its capital structure or its publicly held and listed common stock.

2. Whether a stockholder owning less than 2/10ths of one percent of the common stock of the debtor, in concert with the Securities and Exchange Commission, can compel transfer of such an arrangement proceeding initiated under Chapter XI to a reorganization proceeding under Chapter X in the total absence of even a suggestion of wrongs done stockholders or other persons. May the Court compel the debtor to forego the economies of Chapter XI for the elaborate, expensive and unnecessary proceedings under Chapter X merely on the request of the Securities and Exchange Commission for amplified investigatory authority, without evidence in the record of some wrong done or contemplated, or substantial question of the fairness or feasibility of the arrangement proposed pursuant to Chapter XI?

3. Whether Chapters X and XI are mutually exclusive and on what basis. Within this question is whether or not Congress intended to prevent debtors from employing Chapter X, when all that such debtors sought or required was an arrangement or composition of their unsecured trade and commercial debts; similarly, whether Congress intended, by removing the "fair and equitable" rule by the 1952 amendment to Chapter XI, that Chapter XI provided the only proper procedure for a composition with unsecured trade and commercial creditors while continuing the interest in the stockholders unchanged.

Statement of the Case

On October 18, 1954 General Stores Corporation, the debtor, filed a petition in the District Court for the Southern District of New York in accordance with the provisions of Sec. 322* of Chapter XI of the Bankruptcy Act for the reason that it was then unable to pay its debts as they matured. It proposed an arrangement of its general unsecured trade and commercial debts (R. 13a), none of which is evidenced by any publicly held security (R. 43a).

A summary of its assets and liabilities attached to the petition showed total assets in excess of total liabilities by $1,600,000. The proposed arrangement would have compulsory effect only on the general unsecured creditors. Under this plan they would receive 100% of their claims, 20% on confirmation of the plan and 20% annually thereafter.** Creditors entitled to statutory priority were to be paid in full (R. 14a).

The general unsecured creditors are: (a) those who are owed for merchandise, services, supplies, rents and salaries, shown in the debtor's Statement of Affairs (R. 41a) to aggregate $524,970.09; and (b) debtor's wholly owned subsidiary, the Stineway Drug Company, on notes aggregating $1,310,000.00 (R. 42a).

The debtor has no funded debts by way of debentures, no certificates of indebtedness of any kind, no bonds, mort

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* 11 U. S. C. § 722; 52 Stat. 907.

** Arrangement plans may be (and they usually are) altered or modified at various stages of a proceeding up to the time of confirmation as authorized by Sec. 363 (11 U. S. C. 763; 52 Stat. 911) of the Bankruptcy Act.

gage certificates, notes or obligations of like character, sold, distributed or in the hands of the general public (R. 42a). No secured obligation and no securities of any kind are affected by or intended to be modified in any manner or form by the arrangement (R. 43a).

The arrangement does not affect or seek to modify in any manner or form the capital stock of the debtor corporation. The authorized capital stock consists of 3,000,000 shares of common stock of the par value of $1.00 each and all of one class, of which there were issued and outstanding at the time of the petition 2,053,922 shares (R. 43a).

At present the debtor has two principal corporate assets. The first is the cash received from the liquidation of the Schulte Tobacco Stores, all of which stores the debtor has discontinued during the pendency of these proceedings; debtor has liquidated its inventories and practically all of its tangible assets.

The second asset is the debtor's equity in the capital stock of the Stineway Drug Company and the Ford Hopkins Company, both wholly owned by the debtor. As a going concern, the debtor also has a valuable asset in a carry forward operating tax loss (R. 66a-67a).

The Intervention to Dismiss Proceedings

On November 9, 1954, upon the petition of Max Shlensky, an alleged owner of 3,000 shares (less than 2/10ths of one percent of the common stock of the debtor), the District Court issued an order that the debtor and the Securities and Exchange Commission show cause why the proceedings for an arrangement under Chapter XI should not be

dismissed unless within a time fixed by the Court the petition be amended to comply with the requirements of Chapter X for the filing of a petition for reorganization under said Chapter (R. 17a). The Securities and Exchange Commission cross-moved for leave to intervene and for the same relief requested by Max Shlensky (R. 23a-28a).

On these motions the Court was asked to consider facts which the debtor submits are irrelevant and immaterial to its right to proceed under Chapter XI. For example:

(a) The outstanding stock is held by some 7,000 stockholders, is traded on the American Stock Exchange, and is in part registered with the Securities and Exchange Commission (R. 30a).

(b) The Corporation, organized in 1915 and formerly known as D. A. Schulte, Inc., was in a Section 77-B reorganization proceeding from 1938 to the consummation of a plan on April 30, 1940. During the war years it enjoyed a profitable operation but in the post-war period its volume began to fall, its profit became narrower, attempts at modernization of the Schulte type chain of stores failed, and the debtor embarked upon a program of discontinuing the operation of its Schulte type stores and purchased the outstanding capital stock of Stineway Drug Company and the Ford Hopkins Company, which owned chains of retail stores in Chicago and mid-western states and supplied other stores (R. 31a-33a).

(c) In November, 1952, the Corporation registered 741,647 shares of its common stock with the Securities and Exchange Commission and its original Registration Statement, dated November 12, 1952, had been periodically re-

vised, the last revision being dated July 21, 1954 (R. 31a). Under date of September 20, 1953 the stockholders were notified of the acquisition of the Stuyeway Drug Company and the reasons therefor (R. 70a-72a). In connection with the annual meeting of stockholders held February 10, 1954 the Corporation solicited proxies and sent out a proxy statement, as required by the rules of the Securities and Exchange Commission, which notified the stockholders of the Corporation's intention to purchase substantially all of the outstanding capital stock of Ford Hopkins Company (R. 67a and 73a-79a). Stockholders endorsed the program by 1,453,822 to 37,434 (R. 83a). The consummation of the Ford Hopkins purchase by the Corporation was reported to its stockholders by letter of June 30, 1954 (R. 79a-85a), and as pointed out, the Corporation's Registration Statement with the Securities and Exchange Commission was then amended as of July 21, 1954 (R. 31a).

The matter was heard by the Court, Dimock, D. J., and an opinion rendered on January 24, 1955 (R. 6a-12a). Motion for reargument was denied (R. 12a), and an order was entered on March 7, 1955 granting the Securities and Exchange Commission leave to intervene and dismissing the proceedings for an arrangement under Chapter XI unless on or before March 15, 1955 the debtor filed an amended petition, or before such date a creditors' petition be filed under Chapter X for reorganization (R. 3a-5a). This is the judgment which has been affirmed by the Court of Appeals except for the appellate court's direction to the District Court to set a new date within which the debtor or its creditors may file an amended petition under Chapter X if they so choose (R. pp. 5a and 9a).

Summary of Argument

The right which Congress has granted a corporate debtor, to seek confirmation of a plan for the settlement, satisfaction or extension of the time of payment of its unsecured debts upon any terms, through a proceeding under Chapter XI of the Bankruptcy Act cannot be denied by the court because the debtor is a "large" corporation and its stock publicly held. So long as the plan affects merely unsecured debts, the court is required to look to the best interests of the creditors, and there is no jurisdiction to recognize as "affected"* any stockholder or any class thereof or to recognize the Securities and Exchange Commission in so far as it seeks to act on behalf of public stockholders.

The 1952 Amendment, by removing from a proceeding in Chapter XI (and not in Chapter X) the rule in the *Boyd* case** that prevented "any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders"*** has removed any threat upon the rights of stockholders in any arrangement for the settlement, satisfaction or extension of the time of payment of the corporation's unsecured debts. It is common knowledge that stockholders "stand to gain by the forbearance of the unsecured trade and commercial creditors."****

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* See Sec. 308 of the Bankruptcy Act and cf. Sec. 107.

** *Northern Pac. Ry. v. Boyd*, 228 U. S. 482 (1913). See also *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106 (1940).

*** *SEC v. U. S. Realty & Improvement Co.*, 310 U. S. 434 at 452.

**** *In re Transvision Inc.*, 119 F. Supp. 134 at 137; aff'd 217 F. 2d 243; cert. den. 348 U. S. 952.

The 1952 Amendment also made no distinction whatsoever in the type of debtor entitled to the benefits of Chapter XI, and one will search in vain for language which will justify dismissing a petition because the debtor is a "large" corporation and its stock publicly held.

However, in the present case the lower courts have followed this Court's decision in the *U. S. Realty* case* as justifying a presumption that "large" corporations with publicly held stock are *ipso facto* improperly in Chapter XI and are without adequate relief there. The reliance by the courts below on the *U. S. Realty* case has continued although it was decided prior to the 1952 Amendment and, in addition, involved a plan to alter and modify its publicly-held debt securities, which the court found on its face, under the statute then in force, could not be confirmed in Chapter XI.

Since that is the only decision by this Court relied upon by the courts below, in spite of very obvious distinctions, we are directing our argument here to the four general points considered by this Court in that case.

First, there can be no question but that the petitioner in this case and its proposed plan fully qualify by statute as a "debtor" and proposed "arrangement" respectively, entitled to consideration by the court in a proceeding under Chapter XI. The plan proposes only an extension of the corporation's trade and commercial debts, not evidenced by any publicly held securities. No alteration or modification of stockholders' rights is proposed. Unlike the situation presented by *U. S. Realty*, no court has said or can say that the plan proposed by General Stores could not qualify for confirmation in Chapter XI.

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* *SEC v. U. S. Realty & Improvement Co.*, 310 U. S. 434 (1940); rev'g 108 F. 2d 794.

Second, in consideration of such a plan, the court is without jurisdiction under the statute at the behest of a stockholder or on motion of the Securities and Exchange Commission, or on its own motion, to dismiss the petition because the debtor is a "large" corporation with public stockholders. Similarly, the court cannot dismiss the petition because it believes that procedures under Chapter X would be more adequate for the court's determination as to what would be in the best interests of the creditors. A transfer to Chapter X deprives debtor and its stockholders of the right to settle with creditors without a compensatory advantage to creditors as a priority over the rights of stockholders.* In addition, wage claim priorities may be lost.

Third, there is no showing of any irreparable damage that might follow unless these proceedings were transferred to Chapter X. Although without jurisdiction, the courts below have nevertheless allegedly exercised discretion to elect between Chapters X and XI in spite of the irreparable damage to the debtor and to the wage claimant creditors referred to. In addition, an official creditors' committee and an attorney representing wage claimants have appeared and argued against the necessity for such a transfer to Chapter X.

Fourth, the exercise of jurisdiction and discretion by the court to deny this debtor the right to proceed in Chapter XI is in violation of the Constitution of the United

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* Sec. 221 (2) under Chapter X contains the requirement under that Chapter that the plan be "fair and equitable" and therefore in compliance with the rule in the *Boyd* case, *supra*, page 8 herein.

States, which gave to Congress all legislative power and particularly the power to establish uniform laws on the subject of bankruptcies throughout the United States. At the time Congress enacted Chapter XI, it was fully familiar with the theory and argument that Chapter XI should be denied to "large" corporations with public stockholders. Congress refused to enact that theory into law, and the courts may not substitute their judgment in this regard for that of Congress.*

POINT I

The Bankruptcy Act has granted to the Court, by Chapter XI, full power to afford adequate relief to the debtor in this case, and therefore, by express provision of the Act, proceeding by Chapter X would be improper.

The essential characteristic of the debtor's petition in this case, as distinguished from the petition in the *U. S. Realty* case,** is the proposed plan. Of the plan in the *U. S. Realty* case this Court said:

> "The case stated most favorably to respondent (U. S. Realty) is that it has proposed an arrangement which appears on its face not to be 'fair and equitable' and hence not to be entitled to confirmation under Chapter XI." (310 U. S. at 456.)

In that case debtor's plan proposed that its guarantee of first mortgage certificates in the aggregate sum of $3,710,500 in the hands of some 900 holders was to be modi-

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* See the full dissenting opinion of Mr. Justice Roberts in the *U. S. Realty* case, *supra*, 310 U. S. at 461, *et seq.*

** *Supra*, page 9 herein

fied by an extension of the maturity of the certificates, a reduction of interest, and the elimination of any guarantee of sinking fund payments. Applying the "fair and equitable" rule of the *Boyd* case*, the debtor's plan was not entitled to confirmation because, while scaling down the claims of these creditors, it did not provide "some fair compensating advantage to them" as a priority to the rights of stockholders.

As thus stated and under the statute then in force (Section 366(3)) the facts in the *U. S. Realty* case compel the conclusion that adequate relief would not have been obtainable by the debtor's petition in that case under the then provisions of Chapter XI, and that promulgation of any other plan would have had to be effected under Chapter X.

The *Mecca Temple* case**, also relied on below***, followed directly on the facts and reasoning of the *U. S. Realty* case, and because the debtor there was not even a stock corporation but rather, a membership corporation, the case contributes nothing to an understanding of the questions in this case. The arrangement proposed by the Mecca Temple directly affected over 1,800 bondholders scattered throughout the country entitled to approximately $1,200,000 in principal and interest, by proposing to pay each bondholder 10c on the dollar over 10 years, without

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* *Supra*, page 8 herein.

** *Mecca Temple v. Darrock*, 142 F. 2d 869 (1944); cert. den. 323 U. S. 784.

*** Judge Clark, below, suggested that the panel which heard the *Transcision* case, *supra* page 8 herein, "rather slighted" the criteria set out in the *Mecca Temple* case. See 232 F. 2d at 236.

recognition of long overdue interest, which the Court of Appeals said was "palpably unjust" on the facts in that case. Again, the court also found that, measured by the *Boyd* rule, *supra*, the arrangement could not be "fair and equitable."

Since the *U. S. Realty* and *Mecca Temple* cases, Congress has deleted the requirement that a plan be "fair and equitable" and has been explicit that:

> "Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interest of its stockholders or members, will be preserved under the arrangement." (Present Section 366.)

On this amendment the House Report* stated:

> "Chapter XI has replaced the old composition procedure under former Section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under Chapter XI, XII or XIII.
>
> "The proposed amendment is designed to remove the fair and equitable provision and by the paragraph (above quoted) added to each of the amended sections it is made clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters."

Absent the "fair and equitable" rule, the basic requirement as to the practical effect of an arrangement in Chapter XI is stated under Section 366 as amended in 1952, namely, that the court be satisfied that—

> "(2) it is for the best interests of the creditors and is feasible . . ."

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*House Report No. 2320, 82d Cong., 2d Sess., page 21.

There has been no suggestion in any of the opinions below that the court is without power under the present provisions of the Bankruptcy Act to confirm the arrangement proposed by General Stores Corporation. Its plan proposes to affect only its unsecured trade and commercial debts not evidenced by any publicly held security.

In two essential particulars, therefore, the relief requested by debtor's petition in the present case differs from the relief requested by *U. S. Realty:*

(a) General Stores wants to alter or modify only the terms of its trade and commercial debts not evidenced by any publicly held security, whereas U. S. Realty wanted to alter and modify only the terms of its guarantee contained in a widely and publicly held security;

(b) General Stores seeks to preserve the interests of its stockholders, which does not prevent confirmation of its plan under present Section 366. The U. S. Realty plan, on the other hand, proposed to scale down the claims of one class of its creditors without some fair compensating advantage to them by altering or modifying the rights of stockholders, and thus could not possibly obtain confirmation under Section 366(3) as then in force because on its face the plan was not "fair and equitable".

In short, adequate relief can, by the terms of Chapter XI as amended by Congress in 1952, be obtained by General Stores on its petition, whereas on the face of the U. S. Realty petition, adequate relief was not obtainable in Chapter XI as it was then in force.

Since the relief General Stores seeks can be obtained by its petition under the provisions of Chapter XI, the court would have been compelled by the provisions of Sections 141 and 146(2) of the Bankruptcy Act to have dismissed its

petition if brought under Chapter X; or in accordance with Section 147 have permitted amendment to comply with the requirements of Chapter XI.

The foregoing analysis of one of the most important questions presented on this appeal follows the argument used by this Court in its opinion in the *U. S. Realty* case, when it found jurisdiction to dismiss the proceeding in Chapter XI on the ground that, since the plan could not be confirmed, the proceeding was improperly brought under Chapter XI (a finding of jurisdiction thereafter codified* in 1952 by the addition of the new Section 328 in Chapter XI of the Bankruptcy Act).

This Court was also convinced of its power with respect to U. S. Realty because it was sure that

> ". . . if respondent had proceeded under Chapter X the judge would have been compelled upon inquiry to

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* As explained by the House Report No. 2320, of the 82d Congress, 2d Session, page 19: "Under Section 147 of Chapter X, a petition improperly filed thereunder, because adequate relief can be obtained by the debtor under Chapter XI, may be transferred to Chapter XI and thereafter, for the purposes of Chapter XI be deemed to have been originally filed thereunder. There is no corresponding provision in Chapter XI for a transfer of a Chapter XI proceeding, if improperly filed thereunder, to Chapter X. The proposed amendment supplies this lack. It codifies the law of the U. S. Realty & Improvement case, and adopts the procedure of Section 147 for transferring the proceeding to Chapter X." The codification of the law of the *U. S. Realty* case contained in the 1952 amendments is therefore limited to the holding that the court has the power to dismiss a petition in Chapter XI if improperly filed thereunder. In our opinion the House Report constitutes no acquiescence in the court's assumption of judicial discretion to dismiss petitions as "improperly brought" merely because debtor is a "large" corporation with public stockholders or because, in the eyes of the court, trade and commercial creditors might find some help in an SEC investigation and report.

> approve its petition on the ground that it complied with the requirements of Chapter X, and that adequate relief could not be obtained under Chapter XI." (310 U. S. at 455.)

This same reasoning, when applied to debtor's petition in this case, compels a contrary answer. Had General Stores moved first under Chapter X, it could not have made the essential allegations of a proper petition under Section 130(7), namely:

> "... specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act."

What is meant by "adequate relief" is clarified by the statute in sections following Section 141 which directs the judge to dismiss a petition in Chapter X if not satisfied that it "has been filed in good faith." Section 146 of the Act directs a finding that a petition shall be deemed not to be filed in good faith if—

> "(2) Adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act;"

Section 147 that follows provides for transfer of proceedings from Chapter X when the petition has been filed under Chapter X

> "... improperly because adequate relief can be obtained by the debtor under Chapter XI of this Act."

Whereas no relief in Chapter XI could be obtained by the debtor, U. S. Realty, or by its petition because of deficiencies on the face of its petition, no such disability exists in the case of the petition of General Stores. Using words

in their normal meaning, General Stores, as a "debtor" by Section 306(3) and 4(a) and as referred to in the above quoted Sections, is entitled to the benefits of Chapter XI of the Bankruptcy Act. Unless it fails to obtain the necessary consent of its creditors and thereafter confirmation of its plan by the court under Section 366 of the Act, all of the relief sought by General Stores can and will be obtained. Even if the statute did not so expressly refer to "adequate relief" as obtained by the *debtor* or by the *debtor's petition*, it would be a most unusual interpretation of the adequacy of the relief available in Chapter XI in this case to say that unsecured trade and commercial creditors not holders of publicly distributed securities as parties "affected" cannot obtain adequate relief merely because no provision is made in this chapter for a report by the SEC. The unsecured creditors are represented by their official Creditors' Committee and in addition, Wage Claimants are represented by their counsel, and both groups have urged the continuance of these proceedings in Chapter XI and are opposed to their transfer to Chapter X.

Since no relief is sought here against public security holders nor against stockholders, it is a strange construction of what is meant by "adequate relief" obtainable by the debtor or by a debtor's petition in this arrangement proceeding which would justify transfer of this proceeding to Chapter X over the objection of the debtor and its unsecured creditors.

On the contrary, the relief which the debtor here seeks, namely, an arrangement with its unsecured trade and commercial creditors, without altering or modifying the rights of its stockholders, cannot be obtained by the debtor or a

debtor's petition in Chapter X, and is the peculiar remedy or relief obtainable in Chapter XI. Since Section 221(2) of Chapter X still retains the "fair and equitable" requirement of a Reorganization plan, the rule in the *Boyd* case* makes the relief requested by General Stores unobtainable in Chapter X. In this case, therefore, it is not a question of whether "adequate" relief can be obtained by the debtor's petition but rather, whether "the" relief sought by the debtor can be obtained anywhere else except under Chapter XI.**

POINT II

In proceedings in Chapter XI to confirm an arrangement not altering or modifying the rights of stockholders, the Court is without discretion to dismiss the proceedings because it believes that the interests of stockholders might be better protected in a proceeding under Chapter X.

Since the courts below rely exclusively on the language of this Court's opinion in the *U. S. Realty* case in justification for dismissing the petition of General Stores Corporation, the error below arises from a failure to recognize the essential distinction between the two cases.

Under the Bankruptcy Act in force at the time of the *U. S. Realty* case, this Court was convinced that under the "fair and equitable" rule no plan could be effected "without some re-arrangement of its (U. S. Realty's) capital

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* *Supra*, page 8 herein.

** See *John Hancock Mutual Life Ins. Co.* v. *Casey*, 141 F. 2d 104 at 107 (1940), cert. den. 323 U. S. 713.

structure"* to provide a fair compensation for the scaling down of the creditors' rights, or in the alternative, that some other plan would have to be proposed which would satisfy the "fair and equitable" rule as being in the best interests of the public mortgage certificate holders without altering or modifying the rights of the stockholders.

Under the first alternative, the Court was justified in desiring the assistance of SEC when re-arranging capital stock, but its dismissal of the proceeding under Chapter XI was then mandatory because no such plan could be confirmed except in a proceeding under Chapter X.

The second alternative, not presented on the record** would have required, the court said,*** the expert aid and advice of the Securities and Exchange Commission, available only under Chapter X, in order to determine whether the supposed advantage to the class of creditors affected (the 900 mortgage certificate holders) was in their best interests. To the extent that this Court justified the exercise of discretion on the second alternative, it was obviously acting on behalf of a class of *creditors* specially committed to the guardianship of the Securities and Exchange Commission. Certainly, on this basis the court's holding constituted no precedent for dismissing the petition of General Stores in this case in the purported interest of its *stockholders*, particularly since their rights are neither proposed, nor required, to be altered or modified in this case.

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* 310 U. S. at 456.

** at page 453.

*** at page 454.

Limit of Interest of Stockholders and SEC as Recognized by Congress in Proceedings under the Bankruptcy Act

Obviously, the intervention of the Securities and Exchange Commission can be justified by the court on behalf of stockholders only where the stock interest is held by the investing public and is to be altered or modified by the proposed plan. It is important to note, however, the very limited recognition accorded by Congress to stockholders and to the Securities and Exchange Commission in the interrelated provisions governing proceedings under the Bankruptcy Act. The Securities and Exchange Commission and stockholders have been granted a status by Congress only in Chapter X and in that isolated instance in Chapter XI when proceedings under that chapter are brought improperly because the relief requested by the debtor cannot be obtained under Chapter XI.

The limited scope accorded SEC and stockholders in the Bankruptcy Act by Congress is demonstrated in that situation when management petitions for the debtor, or a creditors' petition is filed, for an adjudication in bankruptcy (under Section 59). Such proceedings threaten the entire interest of stockholders, whether or not they are members of the investing public, and in most cases also seriously prejudice the public investors in debt securities. Notwithstanding such destruction of values, the Securities and Exchange Commission has no status to intervene on behalf of such public investors, although, in an involuntary bankruptcy proceeding the debtor may petition for an arrangement under Chapter XI (Section 321) or for a reorganization under Chapter X (Section 127), and in a voluntary bankruptcy proceeding the creditors may petition for a reorganization under Chapter X (Section 127).

It is not surprising, therefore, that Congress has similarly made no provision for the protection of stockholders as persons affected in an arrangement proceeding under Chapter XI. In simple bankruptcy, Congress assumed that the stockholders have lost their interest. In an arrangement proceeding for a composition of the unsecured debts, Congress correctly assumed that the stockholders were not proper parties because they were not "affected". (Section 308).

Suppose the petition of the single stockholder in this case, owning less than 2/10ths of 1 per cent of the common stock, were somehow competent evidence of the lower court's conclusion* that stockholders in this case are "concerned" because their interests are not being protected in the present Chapter XI proceeding, or that stockholders "fear" the change from the Schulte type stores to regular drug stores may only postpone liquidation or reorganization. There would still be no more basis for the court's exercise of discretion to force these proceedings into Chapter X than there would be for a court in a simple bankruptcy proceeding to act at the behest of stockholders who would prefer to see the debtor avoid adjudication by transferring the proceeding into a reorganization.

Reverting to this Court's opinion in the *U. S. Realty* case, we can embrace the argument that the Securities and Exchange Commission was properly allowed to intervene in that case when some rearrangement of capital stock appeared inevitable for compliance with the "fair and equitable" rule of the *Boyd* case. Similarly we do not have to argue against this Court's opinion in the *U. S.*

* 222 F. 2d 234 at 236

Realty case as to the interest of the Securities and Exchange Commission in that case in the mortgage certificate holders. They were undoubtedly part of the public specially committed to the guardianship of the Commission and their rights and interests were being directly altered or modified by an arrangement which this Court said appeared on its face not to be "fair and equitable" (310 U. S. at 456).

On the other hand, after the 1952 Amendments had clearly distinguished between Chapters X and XI by the removal of the "fair and equitable" rule from the latter and not from the former, the *U. S. Realty* case is still being cited* as authority in the court to consider in a preliminary application the relative adequacy of the two chapters to a particular case, as if there were still alternative remedies and that all that a debtor can secure rightly or equitably in a Chapter XI proceeding is to be had in a Chapter X proceeding.** Although the debtor may not obtain the same relief under both chapters, the court below has assumed a discretionary power to "evaluate the sufficiency of the remedy for the apparent need . . . at the beginning of the proceedings."*** By what statutory authority can the court undertake such a preliminary investigation to determine which is the best remedy and which the more appropriate proceeding, whether to effect a composition with creditors not requiring an alteration or modification of stockholders' rights or to reorganize the corporation involving a rearrangement of its capital stock structure or, in the last analysis, to liquidate before the remaining assets are dissipated?

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* 222 F. 2d 234 at 236.

** The assumption by this Court in *U. S. Realty* at p. 456.

*** At p. 237.

However theoretically ideal such a preliminary exploration under the aegis of the court with the advice of the Securities and Exchange Commission might appear, such is not the policy of the Bankruptcy Act as written by Congress. Only the debtor or its creditors may move a proceeding out of straight bankruptcy in which proceeding the Securities and Exchange Commission has no part. Congress has encouraged all debtors who seek only a composition with their unsecured creditors to proceed in Chapter XI (making it improper for the court to entertain such a petition in Chapter X). The Securities and Exchange Commission and stockholders have been given only the most limited status in Chapter XI to be exercised only if debtor's petition is improperly in that chapter.

The Formality and Adequacy of Proceedings in Chapter XI in the Interests of Creditors

Much of the pressure on appellate courts to transfer proceedings to Chapter X is based upon the erroneous argument that Chapter XI is "informal", "summary" and under the "control of the debtor." Of course that is not so. The error of such argument is most apparent in a case like the present involving only trade and commercial debts, none of which is evidenced by publicly held securities.

A proceeding in Chapter XI is not under the control of the debtor, but rather, under the control of the court acting particularly in the interests of the unsecured creditors represented by their creditors' committee. The debtor must file with the court in the first instance (Section 324) a statement of executory contracts, schedules of its property, lists of all its creditors in form like those filed by a bankrupt (Section 7a(8)) and a statement of its affairs. Under the

District Court rules of the Southern and Eastern Districts of New York (Rule XI-2) the debtor must also file immediately with its petition a list of its ten largest creditors and it is the court's duty, upon the filing of a petition and on notice to these ten creditors (Rule XI-4(a)) to promptly hold a hearing, as provided by Section 326, to determine the question as to whether the debtor should file a bond or other undertaking to indemnify the estate against subsequent loss thereto or diminution thereof, and to call a meeting of all creditors within 30 days (Sec. 334; Rule XI-4(b))

As a practical matter, the initiative in the proceeding which may have been with the debtor upon the filing of the petition, now shifts entirely to the court with the advice of the ten largest creditors, and it is they who decide whether indemnity is required and in what amount. As a practical matter, also, the court may then impose conditions upon the action of the debtor in lieu of or in addition to indemnity, as may be suggested by the ten largest creditors, such as the countersigning of checks, limitations upon purchase and sale of goods and incurring expenses without the consent of the creditors' designee, etc.

Certainly by this time, if not long before, a creditors' committee has come into being and this committee, by the 1952 Amendments to the Bankruptcy Act, has an official status in the proceeding even before the first meeting of all general creditors (Section 338). Of the function of a creditors' committee the House Report on the 1952 Amendment states:

> "It has been held that the 'committee of creditors' means the official committee appointed under Section 338; that the only expenses allowable are those incurred by such committee, its attorneys or agents after

the appointment, and are further restricted to the expenses incurred by them in passing judgment upon the plan and making such judgment known to the debtor and creditors; and that the expenses incurred by any other committee, its attorneys or agents are not allowable. Lane v. Haytian Corp. of America, 117 F. 2d 216 (1941).

"The provisions have not worked out satisfactorily. The appointment of the official committee at the first meeting of creditors, at which are also received and determined the acceptances by creditors of the arrangement (Section 336(4)) gives such official committee little opportunity, if any, to function for the benefit of creditors in passing judgment on the arrangement unless the proceeding, which has been fashioned to be streamlined, is delayed and slowed up in order to enable the committee to make its investigations and examinations, and to secure any desired improvement or other modification in the terms of the offer for the benefit of creditors. Obviously, the provisions are badly timed in their coordination and are not realistic.

"Moreover, negotiations for a settlement between a debtor and his creditors are generally started before Chapter XI is resorted to, in the hope that an out-of-court arrangement can be effected. When this attempt fails, usually because of a recalcitrant minority, Chapter XI is resorted to in order to bind a non-accepting minority. But before the arrangement petition is filed, much, if not all, of the spade work may have been done, such as investigations, book examinations, solving of legal problems and negotiations which developed or will substantially contribute toward the development of the arrangement, and the unofficial committee, its attorneys and agents, usually continue to render services after the petition is filed and until the first meeting of creditors, at

which the official committee may be appointed." (House Report No. 2320, 82nd Cong., 2d Sess., pp. 19 and 20)

It is important to note, however, that in amending Chapter XI in 1952 to recognize and reimburse the unofficial creditors' committee and its agents, the necessary qualifications of such committee were retained. As the House Report stated:

"Such committee must have been selected by not less than a majority in amount of the unsecured creditors (exclusive of the disqualified creditors enumerated in Section 44) and in fixing allowances, only the services which contributed to a confirmed arrangement, or, carrying through the objections of Section 661a(3), to the refusal of the confirmation of an arrangement, or which were beneficial in the administration of the estate, are to be considered by the court. The first qualification avoids ramp committees and permits of only a single committee which must represent not less than the majority interest; the second qualification limits the type of services, and the proper costs and expenses incidental thereto, which the court may consider in fixing the amount of the allowance." (Ibid., p. 20)

Since, as a practical matter, the debtor cannot make any move without the consent of the court and the court, as a practical matter, will be persuaded by the advice of a creditors' committee as to what are reasonable restrictions upon the activities of a debtor, the debtor is

* The following are prohibited from acting as "creditors" in appointing a creditors' committee: debtor's stockholders, officers and members of its board of directors or other similar controlling bodies.

no longer in control of his business. As a practical matter also, a debtor who in good faith seeks a composition with his creditors in Chapter XI is no longer in control of that proceeding because he is found thereafter to negotiate with and observe the recommendations of the creditors' committee if he expects to obtain the requisite acceptances for his plan. In practical effect, the plan ceases to be the debtor's but, rather, a negotiated plan which has the recommendation and approval of the creditors' committee.

Under these circumstances also, the debtor is forced to provide the creditors' committee and its accountant and attorney with all of the necessary financial facts upon which the creditors' committee may act. For a non-cooperative debtor, Section 21a examinations are fully authorized in Chapter XI (Section 302) and as a practical matter, with this power the court usually directs a debtor to make available to a creditors' committee and its accountants and attorney whatever the creditors' committee deems necessary under the circumstances, including a complete investigation of the debtor's books, records, documents and affairs.

The recalcitrant debtor faces a denial by the court of confirmation of his plan if he refuses to obey any lawful order of, or to answer any material question approved by, the court (Section 366(3) and Section 14c(6)).

Throughout the Chapter XI proceeding the debtor is constantly faced with adjudication in bankruptcy or dismissal of proceedings if he fails to satisfy his creditors and the court that his plan is in the interests of the creditors.

Although it is true, in the Southern District of New York, that the court does not as a regular practice appoint receivers of a debtor in Chapter XI, we understand that the opposite is the practice in the district courts of a number of other states. In view, however, of the power of the court in a Chapter XI proceeding over the actions of the debtor, it may well be that a receiver is not required. In any case, there is no greater fallacy than to assume that a proceeding in Chapter XI is "informal", "summary" or that the debtor is "in control" of the proceeding.

The Inadequacies of Proceedings in Chapter X in the Interests of the Debtor and Its Stockholders

Pressure on the court to transfer proceedings in Chapter XI to proceedings in Chapter X is often based on another fallacious assumption:—that everything the parties interested in a Chapter XI proceeding could get in that proceeding can be obtained by a petition in Chapter X. This is far from the truth.

(a)

The most important distinction is that Chapter XI alone provides relief to the debtor and its stockholders by effecting a composition with unsecured creditors without at the same time necessarily requiring a compensatory advantage to such creditors as a priority over stockholders. This important advantage of Chapter XI over Chapter X arises from its origins as the successor of the composition Section 12 of the Bankruptcy Act of 1898 as confirmed by the 1952 Amendments to the Bankruptcy Act which corrected the holding by this Court in the *U. S. Realty* case.

(b)

There is another important advantage to Chapter XI which is not clearly appreciated by some of the appellate courts, namely, the loss in a proceeding under Chapter X of all of the experienced management of the debtor. It is not true that management is *ipso facto* in error because a corporation is in financial difficulties. There are many economic factors which may have caused the difficulties and which may not be laid to the door of management.

However, a Chapter X proceeding, when all that is needed is an extension or scaling down of unsecured debts, constitutes a confession that management has no feasible plan acceptable to its unsecured creditors and that its initiative and judgment ought to be taken over by the SEC and the court.

(c)

Finally there is the not inconsiderable burden of expense and dangers of delay which are the necessary characteristics of a proceeding in Chapter X and which are usually avoided by a proceeding in Chapter XI.

In *U. S. Realty*, this Court adverted (310 U. S. at 449) to the provisions in Chapter X that require in that proceeding the appointment of a disinterested trustee, Sections 156-158, and a thorough examination and study by the trustee of the debtor's financial problems and management, Section 167(3)(5). The trustee is required to report on the result of his study, to send the report to all security holders with notice to submit to him proposals for a plan of reorganization, Section 167(5)(6). He then formulates a plan or reports the reasons why a plan cannot be formulated, Section 169. If the Judge finds the plan presented

worthy of consideration, he must in all cases where the liabilities of the debtor exceed $3,000,000 (and he may in smaller cases) refer the plan to Securities and Exchange Commission for report. Section 172. The report of the Securities and Exchange Commission and the opinion of the Judge approving the plan must then be submitted to creditors, Section 175.

The expenses of such elaborate proceedings are considerable. The trustee, reorganization manager, creditors' committees, stockholders' committees and their respective counsel and agents must be reimbursed and compensated. The proceeding has been correctly labelled "detailed and cumbersome"*, and "elaborate investigatory and protective procedures."**

But merely because Chapter X requires such elaborate, detailed, cumbersome and expensive procedures does not mean that proceedings under Chapter XI in contrast are "informal" or "summary." Where the capital structure and secured debts must be rearranged and adjusted in addition to effecting a composition with unsecured creditors, a much more elaborate procedure must necessarily be used. There is no reason, however, why such an elaborate procedure must be followed when all that is required is a composition with unsecured creditors. To use the more cumbersome proceeding is a waste of money and time.

In short, Chapter XI, not Chapter X, provides adequately for the interests of the debtor and unsecured creditors, and so long as the plan seeks a composition with

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* 310 U.S. at 464.

** 217 F. 2d at 246.

unsecured creditors not public security holders, there is no basis in the statute for stating that adequate relief cannot be had in Chapter XI. No modification or alteration in the rights of stockholders is contemplated, and it is unrealistic to make a distinction between the debtor and its stockholders, since stockholders are bound to gain by the composition.

Since Congress has made available in Chapter XI relief to a financially embarrassed corporation which may not be obtained in Chapter X, it requires the very clearest language in the statute for the court to deprive a particular corporation of the benefits of Chapter XI. There is nothing in the policy of the Bankruptcy Act which requires a dismissal of the petition under the circumstances of this case.

POINT III

No basis was presented in this case for the exercise of the Court's discretion to withhold relief under Chapter XI, even if Congress had authorized the use of such discretion.

To the extent that the courts below in this case may be said to be applying their discretion on behalf of creditors, they have acted without recognition of the adequacy of Chapter XI to proceed in the best interests of creditors.* In any event, there is nothing alleged in this case as to any irreparable damage to creditors threatened by a continuance of these proceedings in Chapter XI.

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* See pages 23, *et seq.* herein.

It is equally true that no similar threat to stockholders by a continuance of these proceedings in Chapter XI is alleged. Judge Clark, below, assumed (on the intervention of one stockholder, owning less than 2/10ths of 1 per cent of the outstanding stock) that stockholders, as distinguished from the debtor, are "concerned" about their stock interest, and that they "fear" that the debtor's program may only postpone liquidation, and that they "wish some assurance" now, before the remaining assets are dissipated.* No allegations of "concern", "fear" or desire for "assurance" have ever been made on behalf of stockholders in this case.

As we have shown, there can be no threat to stockholders in a proper proceeding under Chapter XI, which seeks only a composition with the unsecured creditors without altering or modifying the rights of stockholders. In any case, the record in this proceeding is barren of any allegation of threatened damage to stockholders which may result from a continuance of these proceedings in Chapter XI.

Certainly, the fact that General Stores (under the name of D. A. Schulte, Inc.) went through a 77-B reorganization from 1938 to 1940, which was more than 14 years prior to the present proceedings, cannot be held to be either relevant or material. The fact that General Stores has, in the immediate past, lost money on the Schulte type tobacco store operation and has been discontinuing them and has purchased a drug store and restaurant chain to take their place, is no evidence of threatened damage to stockholders by continuance of the Chapter XI proceeding.

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* 222 F. 2d 234 at 236.

Neither the single stockholder, Max Sidensky, nor the Securities and Exchange Commission, has alleged that anything done by the debtor has been improper or even improvident. General Stores has been registered with the SEC since 1952, and all of the facts alleged in the intervenors' petitions come from the information filed by General Stores with the SEC and, in many cases, distributed as informative letters to all the stockholders. If the Securities and Exchange Commission felt that the action of management needed investigation to prevent irreparable damage to stockholders by a continuance of the Chapter XI proceeding, it has neither made that charge nor presented any facts from which that charge could be inferred.

For all that the court knows, an investigation by the Securities and Exchange Commission in a Chapter X proceeding would do no more than confirm the sound business judgment of debtor in getting out of the Schulte type stores and into the drug store and restaurant chain business, and that from economic causes beyond the control of management, debtor is financially embarrassed and needs only time from its unsecured creditors or a scaling down of its unsecured creditors' claims.

Resort to the expensive, cumbersome, elaborate and long drawn out procedures of Chapter X to reach eventually such a conclusion would be totally unnecessary. This would be true even if the relief of simple composition were available (which it is not) in a Chapter X proceeding.

Even if there were an equity interest of stockholders existent and properly pleaded, which we certainly deny, the court is bound to weigh the great disadvantages to the other parties interested by a dismissal of these proceed-

ings. We have already pointed out that the debtor and its stockholders cannot obtain the same relief in a proceeding under Chapter X and that the relief available in Chapter XI must surely be in the better interests of the stockholders than any "reorganization" under the provisions of Chapter X.*

We have also pointed out the important position of a creditors' committee in Chapter XI,** and we emphasize that the creditors in this case as represented by their Creditor's Committee believe it is in the interests of creditors that these proceedings continue in Chapter XI.

Finally, this Court has been made aware of the interests of wage claimants who feel that they will be very badly prejudiced by a dismissal of these proceedings.*** The filing of the petition under Chapter XI has created priorities for these wage claimants under Section 64a of the Bankruptcy Act for payment of wages not exceeding $600 each, earned by them within three months prior to the filing of the Chapter XI petition. The wage claimants point out that the priority of wage claimants recognized under Chapter XI and in straight bankruptcy do not apply in Chapter X (Sec. 102).

There is no basis, therefore, against the interests of general creditors and wage claimants, as well as against the interest of the debtor and its stockholders, considered realistically, for the court to assume equity jurisdiction to

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* *Supra*, pages 18 and 28 herein.

** *Supra*, page 24 herein.

*** Petition and Brief of Respondents, Wage Claimants, filed on application for Writ of Certiorari in this case.

deny relief to the petitioner in this case under Chapter XI. Mr. Justice Roberts, in his dissent in the *U. S. Realty* case, has denied that the court has the power to dismiss this type of proceeding on the basis of "equity", stating:

> "The legislature has specified who is entitled to the relief provided by the statute and in what circumstances. The court has no power to refuse that relief on the ground that some other relief would better serve the purpose. What is meant by the statement that a court of bankruptcy is a court of equity is that its function is to make an equitable distribution of the estate among the creditors, but the principle has not been applied in the sense that the court may, in its better judgment, refuse to award the relief which Congress has accorded the bankrupt." (310 U. S. at 468.)

This may be contrasted with the prevailing opinion of this Court in the same case, in which Mr. Justice Stone said:

> "We cannot assume that Congress has disregarded well settled principles of equity, the more so, when Congress itself has provided that the relief to be given shall be 'fair and equitable and feasible'." (310 U. S. at 468.)

It seems clear that when Congress in 1952 corrected Chapter XI and omitted the requirement that relief to be given shall be "fair and equitable and feasible" and instead, left to the court to determine whether it was "in the best interests of creditors", Congress at the same time withdrew from the court the discretionary power asserted in *U. S. Realty* to grant or withhold relief under Chapter XI on an equitable basis and in the interest of others than creditors.

Certainly the deletion of "fair and equitable" from the statute in 1952 was no codification of the law expressed by this court in *U. S. Realty* but rather a fundamental correction. From 1952 it is clear that in an arrangement proceeding requiring no relief from stockholders, the court lacks discretion in the interests of stockholders on general allegations of convenience of the Securities and Exchange Commission to dismiss the proceeding. A court has no discretion, in the interest of stockholders, to dismiss the proceeding merely to provide the Securities and Exchange Commission an investigatory status in addition to what it already possesses under the Securities and Exchange Act of 1933.

POINT IV

The denial of relief under Chapter XI in this case is in derogation of the supreme constitutional right in Congress to establish uniform laws on the subject of bankruptcy.

The largest question with which this Court dealt in the *U. S. Realty* case (although not directly presented in that case) is whether a court can deny the debtor the right to proceed in Chapter XI although the debtor and debtor's plan fully qualify under the Congressional statute. That is the question which is directly presented in the present case, and, we assume, influenced this Court to grant certiorari.

Of course, if Chapters X and XI are elective proceedings providing equally satisfactory relief to the debtor, the debtor could have no grievance. But Congress expressly made the Chapters mutually exclusive so far as the

adequacy of the relief to the debtor is concerned.* By the 1952 Amendment, Congress returned to Chapter XI the availability of relief as recognized in the former composition section of the Bankruptcy Act of 1898,** which relief to the debtor is totally unavailable in Chapter X, namely, the right to an arrangement extending, modifying or scaling down unsecured debts without a compensatory change in the rights and privileges of stockholders.***

What Congress has given, may the courts take away?

This Court does not need to be reminded that all legislative powers, and in particular, the power to establish uniform laws on the subject of bankruptcies throughout the United States, have been granted by the Constitution to Congress.**** Where statutory language is as plain and unambiguous as it is in Chapter XI, recourse should not be had to legislative history and other extraneous aids to construe the language in some other sense or to add to or to subtract from what is written.***** To find an unexpressed Congressional purpose to deny a right to proceed in Chapter XI which the language of that chapter rather clearly grants, goes beyond the construction of the Act as it is written, and amounts to an amendment of it.

There is nothing unclear in the statute as enacted by Congress with regard to the qualifications of a debtor entitled to petition and proceed in Chapter XI.

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* Sections 130(7), 141, 146(2) and 147.

** Section 12 of the Bankruptcy Act of 1898.

*** See, *supra*, pages 18 and 28 herein.

**** Constitution, Article I, Section 1 and Section 8, Clause 4.

***** Mr. Justice Roberts in the *U. S. Realty* case, 310 U. S. at 1056 and cases cited by him.

By Section 306(3), Congress has defined such a debtor as "a person who could become a bankrupt under Section 4" of the Act. Section 4 states:

> "a. Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt."

The arrangement which such debtor may present to the court for confirmation is defined by Congress as "any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms" (Section 306(1)).

It was clearly recognized by this Court that there was nothing in the language of Chapter XI which compels a finding that a "large" corporation cannot become a debtor under Section 306(3) or that an arrangement with regard to a debtor's unsecured debts cannot be confirmed in Chapter XI where there are public stockholders. This Court expressly stated that

> ". . . we find in neither chapter any definition or classification which would enable us to say that a corporation is small or large, its security holders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other."* (310 U. S. at 447.)

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* The apparent conflict between Chapters X and XI, if the arguments of the SEC were to prevail, was noted before this Court's decision in the *U. S. Realty* case in 48 Yale Law Journal, p. 1334 at 1364, and after the decision of this Court, in 40 Columbia Law Review, 1245 at 1251. The omission of status of the SEC in straight bankruptcy and the failure of Congress to expressly amend the law in accordance with the contentions of SEC, seems to have escaped the commentators.

It is most significant that this Court was not content in the *U. S. Realty* case to base its decision on a construction of the statute "as if" it contained a statutory limitation upon those qualified to proceed under Chapter XI. As we have pointed out, this Court emphasized by the express terms of the statute that it was not the character of the debtor, but rather, the effect of the debtor's plan under the "fair and equitable" rule which disqualified U. S. Realty from proceeding in Chapter XI. How much simpler it would have been, had Congress in fact limited the availability of Chapter XI, for this Court to have held that "debtor" by definition in Chapter XI excludes, as Judge Frank, below, suggests, any corporation whose securities are substantially held by the public or listed on any Exchange, and whose assets exceed approximately $1,000,000.*

This Court, instead, held that it had a right to dismiss the petition in the *U. S. Realty* case upon the failure of the plan in that case to qualify for confirmation, and suggested that under the "fair and equitable" requirement of the statute, the hope of presenting any plan which might be confirmed under Chapter XI was at best but negligible. In the absence of a provision in Chapter XI corresponding to Sections 146(2) and 147 of Chapter X, this Court assumed power in the initial stages of the proceeding under Chapter XI to dismiss the petition rather than permit the proceeding to continue to the inevitable dismissal under Section 376 when the plan would fail of confirmation.

It was this power in the court to early dismiss a proceeding, if improperly filed, which was codified by Congress

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* 222 F. 2d at 237.

in 1952 in the new Section 328.* Nowhere in that new Section 328 is there any recognition of a new limitation upon the type of "debtor" entitled to the benefits of Chapter XI. Nor is there any recognition of a new discretionary power in the court to substitute its decision for that of the debtor on the question of whether the attempt should be made to settle with creditors without altering or modifying the stockholders' rights, rather than to lose this advantage by reorganizing in Chapter X.

What Mr. Justice Roberts said in his dissenting opinion in the *U. S. Realty* case is much more applicable to the facts and contentions in our case because the issue here is so much more clearly drawn. No class of the unsecured debts of General Stores Corporation is evidenced by publicly held securities, and the only persons falling within a class over whom the Securities and Exchange Commission can be said to have special guardianship are the stockholders, who must gain by a composition with creditors and may well lose in a reorganization. Judge Roberts, in the *U. S. Realty* case, said:

> "Where the words are as plain and unambiguous as they are in Chapter XI, recourse cannot be had to legislative history or other extraneous aids to construe them in some other sense, to add to, or to subtract from, what is written (citing precedents)." (310 U. S. at 462.)

Reviewing, however, the material before Congress at the time of the adoption of the Chandler Act, it seems clear that no narrow application of Chapter XI to small corporations which had not issued securities to the public was

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* House Report No. 2320, 82d Congress, 2d Session, page 19. See also note to page 15 herein.

ever intended. Mr. Justice Roberts points out that Congress consciously rejected such a limitation:

> ". . . that Chapters X and XI were not written in ignorance of the distinction between corporations having publicly owned securities and those which have not, is shown by the fact that a special committee's report called attention to this difference and suggested that corporations not having such securities outstanding be permitted to go under the arrangements chapter whereas the first named should be required to file under what is now Chapter X.* With this suggestion before it, Congress adopted a different criterion." (310 U. S. at 466.)

The inescapable conclusion from the problems raised in the courts on the application of this Court's decision in the *U. S. Realty* case demonstrates that the arguments presented by the Securities and Exchange Commission ought to be addressed to Congress and not to this Court. The failure of the Securities and Exchange Commission over the past seventeen years to obtain recognition of its position from the Congress demonstrates that the legislative policy which it suggests in this case does not exist. As between the claims of the Securities and Exchange Commission and those of corporate debtors, Congress has refused to deny the benefits of Chapter XI to corporations merely because they are large or their securities publicly held. Congress does not believe that the advantages of composition with unsecured creditors (which advantages will flow to stockholders whose rights will be unaltered) should be withheld from large corporations and their public stockholders.

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* Sen. Doc. 268, 74th Cong. 2d Sess., pages 9-15.

In the last analysis, the function of the Securities and Exchange Commission within the framework of each of the separate proceedings authorized by the Bankruptcy Act must be established by Congress, and it is from that body that the Commission must obtain its mandate. Certainly, in the absence of any equitable considerations presented by the Securities and Exchange Commission in this case, there is no need whatsoever for searching for any unexpressed policy of Congress at variance with the clear statutory language of Chapter XI as presently in force.

CONCLUSION

The decision of the Court of Appeals should be reversed with a mandate that the District Court deny the applications of the respondent Max Shlensky and the Securities and Exchange Commission so that this proceeding for an arrangement may continue.

Respectfully submitted,

AARON ROSEN,
Counsel for Petitioner.

FREDERIC P. HOUSTON,
MARKS F. PASKES,
MELVIN LIEBOWITZ,
of Counsel.

November 24, 1955.

APPENDIX

Constitution, Article I.

SEC. 1:

All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

SEC. 8, Clause 4:

The Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.

Statutes

Pertinent provisions of the Bankruptcy Act of 1898, as amended and of the Chandler Act of 1938 as amended follow:

Bankruptcy Act of 1898, as Amended: Section 12(d) (11 U. S. C. Sec. 30(d); 30 Stat. 549).

SEC. 12. Compositions; when confirmed. . . .

(d) The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors; (2) the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge; and (3) the offer and its acceptance are in good faith and have not been made or procured except as herein provided, or by any means, promises, or acts herein forbidden.

The Chandler Act of 1938, as Amended (11 U. S. C. 1 et seq.; 52 Stat. 840).

A. From Chapters I to VII:

SEC. 4 (11 U. S. C. 22; 52 Stat. 845). Bankrupts: Who may become:

a. Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

SEC. 7 (11 U. S. C. 25; 66 Stat. 422). Duties of bankrupts:

a. The bankrupt shall

(8) prepare, make oath to, and file in court within five days after adjudication, if an involuntary bankrupt, and with his petition, if a voluntary bankrupt, a schedule of his property, showing the amount and kind of property, the location thereof and its money value, in detail; and a list of all his creditors, including all persons asserting contingent, unliquidated, or disputed claims, showing their residences or places of business, if known, or if unknown that fact to be stated, the amount due to or claimed by each of them, the consideration thereof, the security held by them, if any, and what claims, if any, are contingent, unliquidated, or disputed; and a claim for such exemptions as he may be entitled to;

SEC. 14 (11 U. S. C. 32; 66 Stat. 422). Discharges, when granted:

c. The court shall grant the discharge unless satisfied that the bankrupt has

(6) in the course of a proceeding under this Act refused to obey any lawful order of, or to answer any material question approved by, the court;

Appendix.

SEC. 21 (11 U. S. C. 44; 66 Stat. 423). Examination of bankrupt:

a. The court may, upon application of any officer, bankrupt or creditor, by order require any designated persons, including the bankrupt and his or her spouse, to appear before the court or before the judge of any State court, to be examined concerning the acts, conduct, or property of a bankrupt:

SEC. 44 (11 U. S. C. 72; 54 Stat. 835). Trustees; creditors' committees; and attorneys:

a. The creditors of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of other similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, appoint a trustee or three trustees of such estate . . .

b. Such creditors may, at their first meeting also appoint a committee of not less than three creditors, which committee may consult and advise with the trustee in connection with the administration of the estate, make recommendations to the trustee in the performance of his duties and submit to the court any question affecting the administration of the estate.

B. From Chapter X:

SEC. 107 (11 U. S. C. 507; 52 Stat. 884). Creditors affected by plan; determination:

Creditors or stockholders or any class thereof shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely

affected thereby. In the event of controversy, the Court shall, after hearing upon notice, summarily determine whether any creditor or stockholder or class is so affected.

SEC. 127 (11 U. S. C. 527; 52 Stat. 885). Pending bankruptcy proceedings:

A petition may be filed in a pending bankruptcy proceeding either before or after the adjudication of a corporation.

SEC. 130(7) (11 U. S. C. 530(7); 52 Stat. 886). Contents:

Every petition shall state

(7) the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act; . . .

SEC. 141 (11 U. S. C. 541; 52 Stat. 887). Petition of debtor:

Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

SEC. 146(2) (11 U. S. C. 546(2); 52 Stat. 887). Good faith of petition:

Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—

(2) Adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; . . .

SEC. 147 (11 U. S. C. 547; 52 Stat. 888). Amendment of petition to comply with provisions governing arrangements:

A petition filed under this chapter improperly because adequate relief can be obtained by the debtor under Chapter XI of this Act may, upon the application of the debtor, be amended to comply with the requirements of Chapter XI for the filing of a debtor's petition, and shall thereafter for the purposes of Chapter XI be deemed to have been originally filed thereunder.

SEC. 221(2) (11 U. S. C. 621; 52 Stat. 897). Confirmation by Court:

The judge shall confirm a plan if satisfied that—

(2) the plan is fair and equitable, and feasible;

C. From Chapter XI:

SEC. 302 (11 U. S. C. 702; 52 Stat. 905). Applicability of other sections:

The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter.

SEC. 306 (11 U. S. C. 706; 52 Stat. 906). Definitions:

(1) "Arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of

the time of payment of his unsecured debts, upon any terms;

(3) "Debtor" shall mean a person who could become a bankrupt under Section 4 of this Act and who files a petition under this chapter;

SEC. 308 (11 U. S. C. 708; 52 Stat. 906). Creditors affected by arrangement; determination:

A creditor shall be deemed to be "affected" by an arrangement only if his interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor is so affected.

SEC. 321 (11 U. S. C. 721; 52 Stat. 907). When petition may be filed:

A debtor may file a petition under this chapter in a pending bankruptcy proceeding either before or after his adjudication.

SEC. 322 (11 U. S. C. 722; 52 Stat. 907). Original petition:

If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication.

SEC. 324 (11 U. S. C. 724; 52 Stat. 907). Accessories to petition:

The petition shall be accompanied by

(1) A statement of the executory contracts of the debtor, and the schedules and statement of affairs, if not previously filed: . . .

SEC. 328, as added in 1952 (11 U. S. C. 728; 66 Stat. 432). Dismissal, proceedings; amended petition:

The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under Chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of Chapter X of this Act for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with Section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed to have been originally filed under such chapter.

SEC. 334 (11 U. S. C. 734; 52 Stat. 908). Meeting of creditors:

The court shall promptly call a meeting of creditors, upon at least ten days' notice by mail to the debtor, the creditors, and other parties in interest.

SEC. 338 (11 U. S. C. 738; 52 Stat. 909). Appointment of committee; nomination of trustee:

At such meeting the creditors may appoint a committee, if none has previously been designated or appointed under this Act, and, if a trustee has not previously been appointed, may nominate a trustee who shall thereafter be appointed by the court in case it shall become necessary to administer the estate in bankruptcy as provided under this chapter.

SEC. 363. (11 U. S. C. 763; 52 Stat. 911). Proposing alterations or modifications:

Alterations or modifications of an arrangement may be proposed in writing by a debtor, with leave of court, at any time before the arrangement is confirmed.

SEC. 366* (11 U. S. C. 766; 66 Stat. 433). Confirmation of arrangement:

The court shall confirm an arrangement if satisfied that—

(1) The provisions of this chapter have been complied with;

(2) It is for the best interests of the creditors and is feasible;

(3) The debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(4) The proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.

Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement.

SEC. 376 (11 U. S. C. 776; 52 Stat. 912). Dismissal and adjudication:

If the statement of the executory contracts and the schedules and statement of affairs, as provided by paragraph (1) of section 324 of this Act, are not duly filed, or if an arrangement is withdrawn or abandoned

* As amended by Act of July 7, 1952, Sec. 35—Public Law 456—82nd Cong., 2d Sess., effective Oct. 7, 1952.

prior to its acceptance, or is not accepted at the meeting of creditors or within such further time as the court may fix, or if the money or other consideration required to be deposited is not deposited or the application for confirmation is not filed within the time fixed by the court, or if confirmation of the arrangement is refused, the court shall—

(1) Where the petition was filed under section 321 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

(2) Where the petition was filed under section 322 of this Act, enter an order, upon hearing after notice to the debtor, the creditors and such other persons as the court may direct, either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act or dismissing the proceeding under this chapter, whichever in the opinion of the court may be in the interest of the creditors.

Court Rules.

RULES OF THE U. S. DISTRICT COURTS FOR THE SOUTHERN AND EASTERN DISTRICTS OF NEW YORK; BANKRUPTCY:

RULE XI-2—Affidavits to be filed with petition

(a) Every petition for arrangement filed pursuant to Section 321 shall be accompanied by an affidavit of the debtor setting forth:

(1) Whether a receiver or trustee was appointed in the prior bankruptcy proceeding, and if so, the name of such receiver or trustee; whether or not a

creditors' committee was appointed under section 44(b) in the prior bankruptcy proceeding, and if so, the names and addresses of the members of such committee;

(2) the names and addresses of the ten largest creditors, excluding (a) those creditors who would not be entitled to vote at creditors' meetings under section 56(b); (b) such creditors as were employed by the debtor at the time of the filing of the petition; (c) creditors who are relatives of the debtor, or, if the debtor is a corporation, creditors who are stockholders or officers or members of the board of directors or trustees or other similar controlling bodies of such debtor corporation; and (d) creditors who have participated directly or indirectly in the act of bankruptcy as charged in the petition;

(3) the nature and present status of each action or proceeding pending or threatened against the debtor or his property, where a judgment against the debtor or the seizure of his property may be imminent; and

(4) a statement of all property of the debtor in the possession or custody of any public officer, receiver, trustee, assignee for the benefit of creditors, mortgagee, pledgee, or assignee of rents, giving the names and addresses of such persons and the court in which such proceedings, if any, are pending.

(b) If the petition is filed under section 322 the affidavit shall set forth the matters required by subsection (a) (2) (3) and (4) of this rule and shall also state whether the debtor is occupying any premises under a lease, and if he is, a statement as to the length of the term, the rent reserved, the amount owing for

rent, and what negotiations for a modification of the lease have been had, if any, with whom and the present status thereof.

RULE XI-4—Hearing on indemnity; first meeting

(a) *Hearing on Indemnity*

The court, after the filing of a petition under Section 322, shall cause a hearing to be held as soon as practicable, upon five days' notice by mail to the debtor, the debtor's attorney, those creditors whose names are listed in the affidavit filed by the debtor pursuant to the provisions of rule XI-2 and to such other parties in interest as the court may direct for the purpose of determining whether or not the debtor shall be required to file a bond or undertaking or deposit cash indemnity, or whether any other terms or conditions shall be imposed in accordance with sections 326, 342 and 343 of the Act.

(b) *First Meeting of Creditors*

In order to carry into effect the provisions of sections 334 to 338 of the Act, the court shall call the meeting of creditors within thirty days after the filing of the petition for arrangement and schedules or list of creditors.